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IN THE  
**Supreme Court of the United States**

OCTOBER TERM, 1944

No. 203

MANUFACTURERS' FINANCE COMPANY,  
*Petitioner,*  
vs.

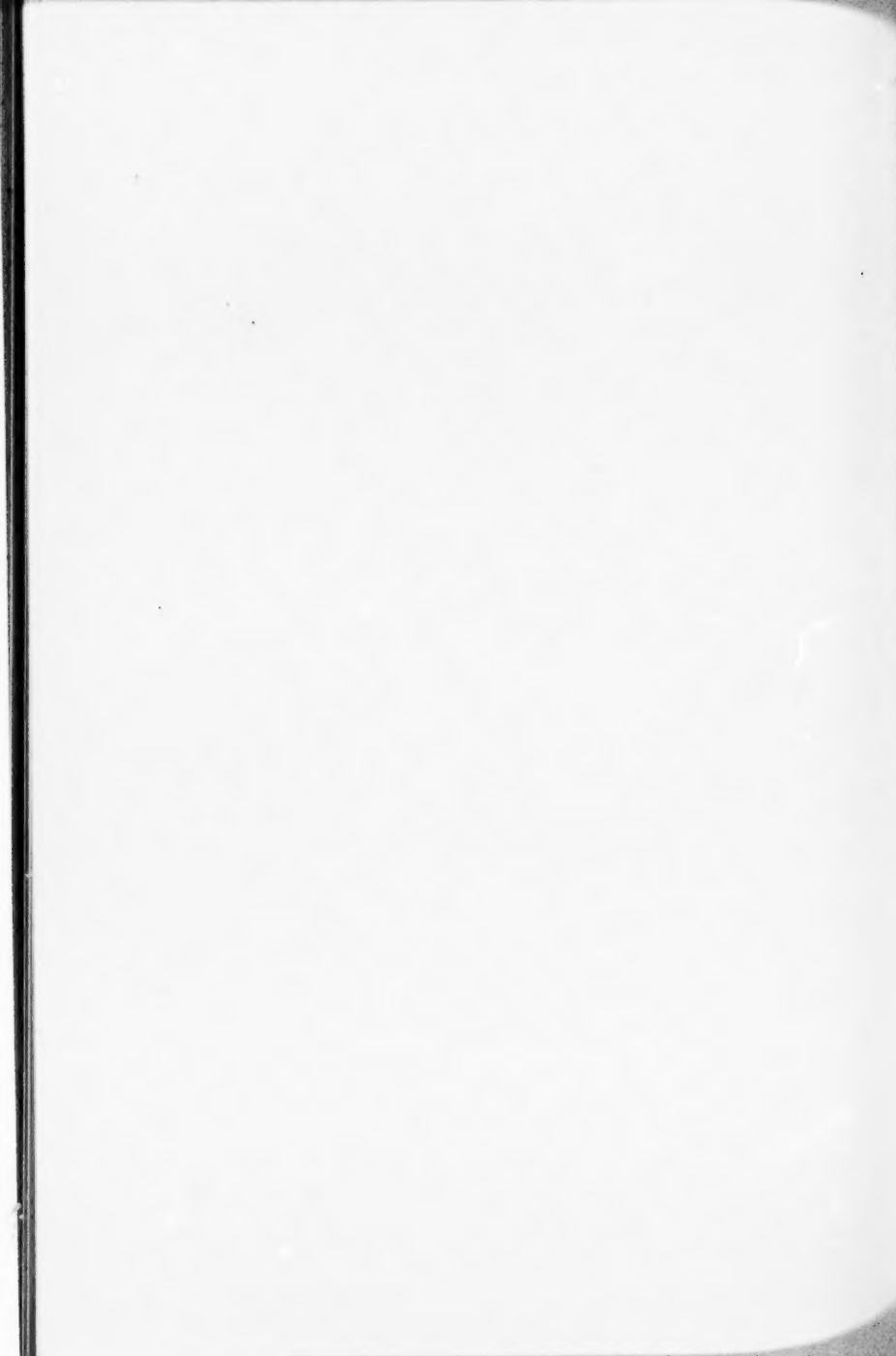
DAVE MARKS, TRUSTEE IN BANKRUPTCY OF  
BELMONT CANDY COMPANY, BANKRUPT,  
*Respondent.*

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**PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE SIXTH CIRCUIT, AND BRIEF IN SUP-  
PORT THEREOF.**

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EDWARD ROTHBART,  
J. M. ROSENFELD,  
of Chicago, Illinois,  
*Attorneys for Petitioner.*



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*To the Honorable, the Chief Justice and Associate Jus-  
tices of the Supreme Court of the United States:*

Your petitioner, Manufacturers' Finance Company, a corporation, respectfully prays that a writ of certiorari issue to the Circuit Court of Appeals for the Sixth Circuit to review a decree of that court entered April 21, 1944\*, affirming a decree of the United States District Court for the Western District of Tennessee, Western Division. A certified transcript of the record in the case, including the proceedings in said Circuit Court of

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\* Petition for rehearing denied May 29, 1944.

Appeals, is furnished herewith in accordance with the rules of this Honorable Court.

### Statement of Matters Involved.

In a voluntary bankruptcy proceeding, petitioner intervened, claiming that some two years prior to bankruptcy it had entered into a contract with bankrupt to purchase its accounts receivable. The identical contract was upheld and enforced by this Court in *Manufacturers' Finance Company v. McKey*, 294 U. S. 442, 79 L. ed. 982. It provided for the purchase of accounts receivable, petitioner paying 100 per cent of the net amount of all accounts purchased, 77 per cent of which was paid upon acceptance of the accounts and the remaining 23 per cent, less certain charges, was paid upon collection of the accounts (R. 10a).

Petitioner alleged (R. 5) that pursuant to the terms of the contract it purchased numerous accounts receivable which remained unpaid; that sums had been collected on such assigned accounts by both the receiver and the trustee in bankruptcy. It prayed that the court direct the receiver and the trustee to account for all moneys collected by them on the assigned accounts, that they be restrained from making further collections, and be directed to transmit all future collections thereon to petitioner. The receiver answered (R. 18) that a small sum collected by him on accounts had been turned over to the trustee. The trustee (R. 11) admitted certain additional collections but alleged that all of the assignments after July 1, 1932 (the date four months prior to the date of bankruptcy) constituted preferences and prayed for an order upon petitioner to pay the trustee the full amount of all such accounts. The trustee asked that his answer be considered as a request for

affirmative relief. Thereafter the trustee filed a supplemental answer and petition (R. 24) and later a further petition, called an amended and supplemental answer and cross petition (R. 56), all asserting the invalidity of the assignments subsequent to July 1, 1932.

The District Court held (R. 271) that the contract between the parties was entered into in due course and until July 1, 1932 performed by both parties; that during the latter part of June, 1932 a diversion of funds took place, bankrupt diverting certain collections made by it on assigned accounts (R. 269); that on July 1, 1932 bankrupt was indebted to petitioner in the sum of \$12,214.20, as security for which petitioner held accounts of bankrupt in the aggregate amount of \$18,632.85 (R. 271). The conclusion of the District Court was (R. 293) that it was impossible, from the record, to tell what accounts were collected after July 1, 1932, there being no way to distinguish the collections made on accounts on hand July 1, 1932 from collections on accounts purchased thereafter; that the transactions of the parties were bona fide in every respect up to July 1, 1932, all of the accounts being obtained for a present consideration and in due course of business (R. 293, 294); that if the indebtedness of \$12,214.20 owing July 1, 1932 had been paid out of accounts on hand at that time there could be no element of preference (R. 294). However, the court held that since the record did not show specifically the source of the collections that were made, and notwithstanding that the trustee was presenting affirmative causes of action against petitioner, it was reasonable to presume that a substantial part of the indebtedness of \$12,214.20 owing on July 1, 1932 was paid out of subsequently assigned accounts; that therefore, it was proper to assume that this entire in-

debtedness was paid exclusively out of accounts assigned subsequent to July 1, 1932 (R. 294, 295), which amounted to a preference recoverable by the trustee, together with interest from the date of bankruptcy, for which amount, and some smaller items, judgment was entered, together with interest amounting to \$10,417.24.

The Circuit Court of Appeals affirmed the judgment, its opinion being unreported as yet, but contained in the record (R. 338). While the opinion recognized that the burden of proof was on the trustee to establish every element of a preference (Op. R. 340) the theory of the District Court was nevertheless affirmed by the Circuit Court of Appeals. It affirmed the District Court's opinion that the transactions between the parties prior to July 1, 1932 were bona fide in every respect and also held that if the indebtedness of \$12,214.20 owing petitioner on July 1, 1932 was paid out of subsequently assigned accounts, the full amount thereof would constitute a recoverable preference (R. 347). Instead of requiring the trustee, however, to establish that the \$12,214.20 was paid to petitioner out of accounts assigned subsequent to July 1, 1932, the court held that since the record did not show what part, if any, was paid out of subsequently assigned accounts, it would be presumed that the entire indebtedness was paid out of accounts subsequently assigned (R. 348). The opinion of the Circuit Court of Appeals is specifically based on this theory.

In other words, it was held that petitioner had received a preference in that the indebtedness of \$12,214.20 was paid exclusively out of accounts assigned after July 1, 1932—and, therefore, that no part of such indebtedness was paid out of the proceeds of the accounts on hand on July 1, 1932. However, as we pointed

out above, the record contains no evidence whatsoever as to the source of the funds paid to petitioner to retire this indebtedness. Both courts found that it cannot be determined from the record whether the collections made after July 1 (which were in the most part collected by bankrupt and remitted by it to petitioner) were collections of accounts assigned prior to or after July 1, 1932, or both.

### Questions Presented.

1. Is a decree warranted which allows the recovery of an alleged preference on the ground that a secured indebtedness was paid wholly out of funds other than the proceeds of the security which secured the indebtedness, where the record wholly and *admittedly* fails to show that such indebtedness was paid, in whole or in part, out of funds other than the proceeds of the security which validly secured the indebtedness?
2. Where a trustee in bankruptcy sues to recover an alleged preference on the ground that a secured indebtedness was retired with funds other than the proceeds of security actually securing the indebtedness, is the burden upon the trustee alleging such preference to establish the identity of the funds allegedly used to retire the indebtedness, or must the defendant establish that the trustee's contentions are not factually correct?

### Reasons for Granting Writ.

1. The decision of the court below in this case is in conflict with the decision of the Circuit Court of Appeals for the 2nd Circuit in the case of *Israel v. Woodruff*, 299 Fed. 454; in conflict with the decision of the Circuit Court of Appeals for the District of Columbia in *Brown, et al v. Christman, et al*, 126 Fed. (2d) 625; and in con-

flict with the decision of the Circuit Court of Appeals for the 9th Circuit in *Stennick v. Jones, et al*, 282 Fed. 161, on the same matter.

2. The court below has decided an important question of federal law in a way probably untenable and in conflict with applicable decisions of this Court and the weight of authority.

3. The court below has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Sixth Judicial Circuit, sitting at Cincinnati, Ohio, commanding said court to certify and send to this Court on a day to be designated, a full and complete transcript of the record and of all proceedings of the Circuit Court of Appeals had in this cause, to the end that this cause may be reviewed and determined by this Court; that the order of the Circuit Court of Appeals for the Sixth Judicial Circuit confirming the decree of the District Court be reversed and remanded and that petitioner be granted such other and further relief as may seem proper.

EDWARD ROTHBART,

J. M. ROSENFELD,

*Attorneys for Petitioner.*





## **BRIEF IN SUPPORT OF PETITION.**

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### **I.**

#### **Opinions Below.**

The District Court did not file a memorandum opinion but his findings of fact (R. 265) and conclusions of law (R. 292) are printed in full in the record.

The opinion of the Circuit Court of Appeals has not yet been officially reported but is likewise printed in full in the record (R. 338).

The opinion of the Circuit Court of Appeals denying the petition for rehearing (R. 351) is likewise printed in full in the record (R. 387).

### **II.**

#### **Jurisdiction.**

The jurisdiction of this Court is invoked under Sec. 240 (a) of the Judicial Code as amended by Act of February 13, 1925 (28 U.S.C.A. Sec. 347A). The date of the decree of the Circuit Court of Appeals for the Sixth Circuit sought to be reviewed was April 21, 1944. The date of the opinion of said Circuit Court of Appeals denying the petition for rehearing was May 29, 1944.

### **III.**

#### **Statement of the Case.**

A brief summary of the issues presented on this appeal has been set forth under the caption "Statement

of Matters Involved." As indicated, petitioner was purchasing accounts receivable from Belmont Candy Company for a period of two years prior to bankruptcy. Under the contract bankrupt made the collections and was required to remit in kind daily (R. 10b). Approximately four months prior to bankruptcy, bankrupt diverted funds collected by it on accounts assigned to petitioner (R. 269). Petitioner, as a condition to purchasing further accounts from bankrupt, required that one of its traveling auditors (who had discovered the diversion of funds) be stationed at bankrupt's premises to insure the forwarding to petitioner of all collections on accounts assigned to it. Petitioner continued to pay the auditor's salary but required that bankrupt pay his expenses at Memphis, Tennessee, which the contract contemplates (R. 10b). Some time thereafter this auditor severed his connection with petitioner and became employed by bankrupt. Petitioner continued to purchase accounts until approximately October 6, 1932 when another diversion of funds took place (R. 203), at which time it notified all of the debtors of the assignments to petitioner of their accounts and refused to purchase further accounts. The petition in bankruptcy was filed on November 1, 1932 (R. 1).

Neither the referee nor the District Court heard or saw any witnesses, the testimony consisting of three depositions and certain documentary evidence. Both courts below found that after July 1, 1932 petitioner's auditor was placed in full charge of bankrupt's business. Petitioner respectfully insists that there is no evidence in the record upon which such findings can be based. Be that as it may, and even assuming such findings to be correct (which we most strenuously insist is wholly disproved by the record) the theory of

both courts below respecting the major items in dispute is admittedly based entirely upon speculation and surmise. Both courts found that the contract was freely and fairly entered into and that the transactions of the parties were bona fide in every respect up to July 1, 1932; that the amount owing on July 1, 1932 of \$12,214.20 was validly secured by accounts in the aggregate amount of \$18,632.85 and that petitioner had a bona fide lien on all of those accounts. Both courts held that if this indebtedness of \$12,214.20 was paid out of the accounts on hand July 1, 1932 there would be no recoverable preference. They both held further that the record did not segregate collections made after July 1, 1932 to show whether those collections emanated from accounts purchased prior to or subsequent to July 1, 1932. Both courts based their conclusions that a preference had been received on the theory that the indebtedness of \$12,214.20 was paid exclusively out of accounts assigned after July 1, 1932. The record admittedly fails to show that such is the fact (R. 293). Therefore, the judgments below are based on the theory that the burden of proof was not upon the trustee to prove the factual foundations and all the elements of the preference alleged by him, but instead, was upon petitioner to *prove* that the unsupported allegations of the trustee were *not true*.

#### IV.

##### Specifications of Error.

The Circuit Court of Appeals erred:

1. In affirming the decree of the District Court.
2. In holding that where the record failed to show how much, if any part of the indebtedness of \$12,214.20

was paid out of accounts assigned after July 1, 1932, it would be assumed that a substantial part of such indebtedness was paid out of subsequently assigned accounts and entering a decree on the basis that the entire indebtedness was therefore paid out of subsequently assigned accounts.

3. In holding that the trustee was entitled to recover any judgment from petitioner.

4. In holding that the burden of proof was *not* upon the trustee to prove the preference he alleged, but was on petitioner to *disprove* the unsupported *contentions* of the trustee.

5. In allowing interest at the rate of 6 per cent per annum from the date of bankruptcy.

### Summary of Argument.

- I. The decision of the court below is in conflict with the decisions of the Circuit Court of Appeals of the District of Columbia and the decisions of the Circuit Court of Appeals for the 2nd and 9th circuits.
  - A. The basis of the decisions below is that petitioner received a preference because the indebtedness owing to it on the day four months prior to bankruptcy was repaid wholly out of security assigned within the four months period.
  - B. The record admittedly fails to show whether any part of such indebtedness was paid out of subsequently assigned accounts.
  - C. The courts below held that upon the trustee making unsupported allegations, the burden was upon petitioner to *disprove* such allegations; that if the record did not contain any evidence on the subject, the trustee's unsupported allega-

tions would be assumed to be true, despite petitioner's denials.

- D. The reported decisions are directly contrary to the holdings of the courts below.
- E. The burden of proof is upon the trustee to establish every element of the preference he alleges.

II. The decision of the court below rests upon two unsupported presumptions—the second built upon the first.

- A. The authorities all hold that a presumption arises that payments made by a bankrupt to creditors are valid.
- B. The courts below refused to apply the above principle of law; instead, two presumptions were indulged in, the second built upon the first. These presumptions are:
  - (i) that a substantial part of the secured indebtedness owing petitioner on the day four months prior to bankruptcy was paid out of security assigned within the four month period.
  - (ii) therefore the *entire* indebtedness was paid exclusively out of security assigned within the four month period.
- C. There is admittedly no record support for either presumption.
- D. The courts below have substituted two unsupported presumptions for a substantive rule of law.

## ARGUMENT.

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### I.

The decision of the court below in this case is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Israel v. Woodruff*, 299 Fed. 454, in conflict with the decision of the Circuit Court of Appeals for the District of Columbia in the case of *Brown, et al. v. Christman, et al.*, 126 Fed. (2d) 625, and in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in the case of *Stennick v. Jones, et al.*, 282 Fed. 161.

As appears from the statement of facts, the vital question involved on this record is whether petitioner secured a preference by receiving payment of an indebtedness admittedly owing to it on July 1, 1932 in the sum of \$12,214.20 (to repay which it had valid assignments of accounts aggregating \$18,632.85). The basis of the decisions below was that such preference was received because said indebtedness was paid out of subsequently assigned accounts exclusively. We shall assume for the sake of the argument that as a legal proposition petitioner would have received a recoverable preference if said indebtedness had been paid entirely out of subsequently assigned accounts. *The record admittedly fails to show whether any part of the indebtedness was paid out of subsequently assigned accounts.*

Who is to be charged with this crucial absence of record proof? Petitioner submits that it is axiomatic that the burden is on the trustee to establish, by com-

petent evidence, every element of the claimed preference. This he admittedly failed to do. But both courts below held that in the instant case, the trustee had no burden to establish his claims. They held that upon the trustee making his unsupported allegations, the burden was upon respondent petitioner to *disprove* the allegations; and that if the record did not contain any evidence on the subject, the trustee's unsupported allegations would be assumed to be true, despite petitioner's denial.

The decision of the court in such respect is an unwarranted departure from established principles, finds no precedent to support it, and is in direct conflict with the decisions of three Circuit Courts of Appeal—the Second and Ninth Circuits, and the District of Columbia.

The identical problem came before the Second Circuit in *Israel v. Woodruff*, 299 Fed. 454. The trustee in bankruptcy there sought to recover alleged preferential payments made prior to bankruptcy. The creditor had loaned money upon the security of certain potatoes in storage and had arranged with bankrupt to sell the potatoes for the creditor's account. The potatoes were sold and creditor's loans paid in full. (The analogy is striking since in the instant case accounts receivable were sold to petitioner, but under the contract bankrupt was allowed to make all collections, turning them over to petitioner as received.) The court held that in order to recover, the burden was upon the trustee in bankruptcy to show that an unlawful preference had been received and that the burden was on the trustee to show that the payments were *not* made from the proceeds of the sale of potatoes on which the creditor had a valid lien. The trustee contended (as is shown on page 457 of the opinion) that the burden was upon

the creditor to trace the funds realized and paid to it by the bankrupt and to show that all of such funds came exclusively from the sale of potatoes on which the creditor had valid liens. The court rejected this contention, saying that the money had been paid and the pledge satisfied and that the burden was upon the trustee, not on the creditor. This is the precise question here presented. Although conceding in its opinion that the burden of proof generally was upon the trustee in bankruptcy (Op. R. 340) the court below held that the burden was not upon the trustee but was, instead, upon the creditor to show the source of the funds paid to it by bankrupt.

The decision of the court below is likewise contrary to the decision of the Circuit Court of Appeals for the District of Columbia in *Brown, et al v. Christman, et al*, 126 Fed. (2d) 625. That was not a bankruptcy case but the principle decided is identical. One Hedges, a real estate broker, had collected rents for numerous property owners whom he represented, and deposited them in a special rent account. At the time of his death Hedges owed about \$21,000 to various property owners for rents collected, but only had in his special rent account the sum of \$2795.41. Plaintiffs, consisting of property owners having about \$10,500 coming from Hedges, sued the latter's administratrix to impress a lien on the funds that were in the special account and prayed that they be distributed to them pro rata. Defendant insisted, among other things, that plaintiffs had failed to show that the funds in the hands of the administratrix were augmented by the trust funds, and that the burden of proof was on plaintiffs to show that no part of the account consisted of anything *other than* trust funds. Rejecting this contention, the court held, page 630:

"There is no evidence in the record to suggest that Hedges deposited any of his own money in the rent account—apart from his interest in the collections—during the period in question. *The burden was upon the estate, therefore, to show that any part of the fund was not of a trust character.*" (Italics supplied)

The decision in the instant case is likewise contrary to the decision of the Ninth Circuit Court of Appeals in *Stennick v. Jones, et al*, 282 Fed. 161. That was an action by a trustee in bankruptcy to recover the value of certain property alleged to have been the property of bankrupt and to have been taken by defendants. A question arose as to what property, if any, not belonging to defendants was taken by them or delivered to them by bankrupt. On this question the court held, page 164:

"The burden of proof was upon the plaintiff to sustain his claim that personal property belonging to the bankrupts, not included in the contract and not paid for out of the \$215,000, was taken by the defendants on May 12, 1914, at the time of the surrender of the property under the forfeiture clause of the contract."

In other words, where bankrupt had delivered property to the creditor and where the trustee claimed that defendant was not legally entitled to receive that property, the court held that the burden was upon the trustee to establish the identity and value of the property so taken, and that it was property which defendant was not entitled to receive.

The decision in the instant case is exactly to the contrary. The court has held that where the record fails to show the source of the collections delivered by bank-

rupt to petitioner the court will presume that the entire indebtedness owing July 1, 1932 was paid out of subsequently assigned accounts. This does violence to all of the decisions of this Court and all of the Circuit Courts of Appeal, which places the burden of proof upon the trustee in bankruptcy who seeks to recover an alleged unlawful preference. The decision is a remarkable departure from established procedure. It presumes that unsupported contentions are true unless *disproved* by respondent. It places the burden of proof on the defendant instead of the plaintiff. On this theory the plaintiff makes contentions and rests; unless defendant *disproves* plaintiff's charges, the charges will be presumed to be true, notwithstanding defendant's denial.

In the instant case, the trustee in bankruptcy was asserting substantive, affirmative causes of action against petitioner. Every authority on the subject requires the trustee to establish the claimed preference and every authority places the burden upon the trustee to prove every element of the alleged preference. The authorities are legion and are collected in Collier on Bankruptcy, 14th Ed. Vol. 3. Sec. 60.62, page 1040 and following, and in Vol. 4, Sec. 67.43, page 363 and following. This burden never shifts from the party having the affirmative of the issue. *Matter of Locust Bldg. Co.*, 299 Fed. 756, 763 (C.C.A. 2) (Cert. den. 265 U.S. 590; 68 L. Ed. 1195). That court stated, page 763:

"The burden of proof never shifts from the party having the affirmative of the issue. But while the burden of proof does not shift, yet during the progress of the proceeding the burden of going forward with the evidence to rebut a *prima facie* case may shift. All this we pointed out in *Cowen Co. v. Houck Mfg. Co.*, 249 Fed. 285, 161 C.C.A. 293. In the proceeding by the trustee for permis-

sion to sell the property covered by the mortgages free and clear of all liens, the burden of proof and the burden of evidence also was on the trustee in the first instance to establish the invalidity of the mortgages. The burden of proof continued with the trustee throughout, and the burden of evidence until at least he made out a *prima facie* case. *United States v. Iron Silver Mining Co.*, 128 U.S. 673, 9 Sup. Ct. 195, 32 L. Ed. 571; *Moffat v. United States*, 112 U.S. 24, 5 Sup. Ct. 10, 28 L. Ed. 623. But we are quite unable to see, upon the evidence in this record, that a *prima facie* case was made out against the Trust Company, and in this case, in our opinion, the burden of evidence, like the burden of proof, remained upon the trustee throughout."

## II.

The fundamental basis of the decision below rests on a presumption admittedly unsupported by the record, and upon another unsupported presumption built upon the first presumption.

As we have above pointed out, and as the Circuit Court of Appeals stated in its opinion (R. 349) the controlling question on this record is the source of the collections made between June 30, 1932 and October 6, 1932. The liability of petitioner is predicated wholly upon the *presumption* that the indebtedness of \$12,214.20 owing petitioner June 30, 1932 was not paid out of the security petitioner had on that date for that indebtedness (accounts aggregating \$18,632.85), but was paid exclusively and entirely out of the proceeds of accounts assigned subsequent to that date.

It is admitted on the record that all of the collections on all accounts during the period from June 30, 1932 to October 6, 1932 were made by the *bankrupt* and for-

warded to petitioner. That was the date after which petitioner purchased no further accounts from bankrupt and several days thereafter petitioner gave notice to the debtors to pay the accounts directly to it.

It is fundamental bankruptcy law that "A presumption arises that payments made by the bankrupt to creditors are valid, and the trustee seeking to recover such payments must overcome this presumption by adequate proof of a voidable preference." Collier on Bankruptcy, 14 Ed. Vol. 3, Sec. 60.62, page 1040 and the numerous authorities cited in footnote 3 on page 1044. Thus, in the absence of any proof to the contrary, a legal presumption arises that all payments made by bankrupt to petitioner, on account of bankrupt's indebtedness to petitioner, were valid.

In *Israel v. Woodruff*, 299 Fed. 454 (C.C.A. 2) the court said (page 457) :

"It is argued that the burden is upon the appellees to trace the funds realized from the potatoes. But the money has been paid and the pledge satisfied. The burden is upon the appellants to show that appellees have received an unlawful preference. *The payments by the bankrupt were consistent with honesty on their part, and the burden was on the appellant to show the payments were not made from the proceeds of the sale of the potatoes. This burden it has not sustained. If one mixes trust funds with his own, the same will be treated as a trust property, except so far as he may be able to distinguish what is his own. National Bank v. Insurance Co., 104 U.S. 67, 26 L. Ed. 693.*" (Italics supplied)

Instead of applying this well recognized and established legal presumption the court below held that since there was no evidence in the instant record from which

it could be determined what part of the collections made after June 30, 1932 were made out of accounts on hand June 30, 1932, and what part out of accounts purchased by petitioner thereafter, it would be *presumed* that a substantial part of the indebtedness of \$12,214.20 owing petitioner on June 30, 1932 was paid out of the proceeds of accounts assigned thereafter. This presumption has no supporting authority. The court, however, went further and built another presumption upon the first presumption. It then presumed that if a substantial part of the indebtedness owing June 30, 1932 was paid out of subsequently assigned accounts it would be further *presumed* that the entire indebtedness owing June 30, 1932 was paid exclusively out of accounts assigned subsequent to that date. These presumptions are indulged in by the court, notwithstanding the admitted fact, as found in the opinion of the Circuit Court of Appeals (R. 349), that the collections after June 30, 1932 exceeded 100 per cent of the face amount of the aggregate of all accounts purchased after June 30, 1932 by some \$5,000.00. (Actually, it affirmatively appears from the record that the collections after June 30, 1932 exceeded 100 per cent of the aggregate face amount of all accounts purchased after that date by over \$10,000.00. See Point II of the Petition for Rehearing, R. 362-372.)

This court has often decided that presumptions must be based upon record proof. Mr. Justice Holmes, in *McFarland v. American Sugar Refining Co.*, 241 U. S. 79, 60 L. Ed. 899, stated, page 86:

"It is 'essential that there shall be some rational connection between the fact proved and the ultimate fact presumed, and that the inference of one fact from proof of another shall not be so unreasonable as to be a purely arbitrary mandate.' *Mobile, J. &*

K. C. R. Co. v. Turnipseed, 219 U.S. 35, 43, 55 L. ed. 78, 80, 32 L.R.A. (N.S.) 226, 31 Sup. Ct. Rep. 136, Ann. Cas. 1912A, 463, 2 N.C.C.A. 243. The presumption created here has no relation in experience to general facts."

The same court which decided the case below stated this proposition very succinctly in *Socony-Vacuum Oil Co. v. Oil City Refiners*, 136 Fed. (2d) 470 (Cert. den. 88 L. Ed. 207) as follows, page 474:

"Presumptions of fact which the law recognizes must be immediate inferences from the facts proved and must be such as sensible men influenced by observation, experience and reason, would draw from clearly established facts."

Their conclusion in the instant case is irreconcilable with the language just cited from their former opinion. The opinion of the court below bases one presumption on another—a practice long condemned by this court. *United States v. Ross*, 92 U. S. 281, 23 L. ed. 707; *Looney v. Metropolitan R.R. Co.*, 200 U. S. 480, 50 L. ed. 564; *Manning v. John Hancock Mut. L. Ins. Co.*, 100 U. S. 693, 25 L. ed. 761.

The conclusion of the court below admittedly finds no support in the record. The decision of the Circuit Court of Appeals specifically points out that it cannot be determined from the record how much of the collections made after June 30, 1932, were on accounts on hand on that date, or how much emanated from accounts assigned subsequent thereto. The first presumption indulged in by the court, that a substantial part of the indebtedness owing June 30, 1932 was paid out of subsequently assigned accounts, is, therefore, a presumption which has no rational connection with any fact

proved in the case. Indeed, it is contrary to the record which shows that over \$10,000.00 was collected after June 30, 1932 over and above 100 per cent of the aggregate face amount of all accounts assigned after June 30, 1932. The result, not by way of presumption, but by way of deduction from facts actually established and proved without contradiction, and a deduction which all sensible men influenced by observation, experience and reason would draw from the established facts, is that at least \$10,000.00 was collected on the accounts already on hand June 30, 1932. Therefore, at least \$10,000.00 of the indebtedness of \$12,214.20 owing June 30, 1932 must necessarily have been paid out of accounts on hand June 30, 1932 (petitioner admittedly having had valid assignments of accounts aggregating \$18,632.85 on hand June 30, 1932 to secure its indebtedness).

It is obvious, therefore, that the court below has not only indulged in a presumption which finds no support in the record, but has indulged in a presumption which is exactly contrary to the admitted facts established without contradiction in the record. Having indulged in that presumption (that a substantial part of the indebtedness owing June 30, 1932 was paid out of subsequently assigned accounts) the court indulged in a second presumption, built entirely on the former, that the *entire* indebtedness owing petitioner on June 30, 1932 was paid out of subsequently assigned accounts. This is the gist of the holding of the court below, its opinion being grounded squarely on that point. Thus the court below has substituted two presumptions, both of which, we submit, are improperly drawn, for a substantive rule of law. The court has thus concluded that as a matter of law it will be presumed that a secured indebtedness owing more than four months prior to

bankruptcy, and repaid by the bankrupt within the four months period, was improperly paid out of proceeds to which the creditor was not entitled; and this without any record proof to support it, and, as a matter of fact, despite the record to the contrary. It is respectfully submitted that in so holding the court below has decided an important question of law in a most untenable way, in conflict with all applicable decisions of this court and the weight of authority generally. It is further submitted that the court in so doing has so far departed from the accepted and usual course of judicial proceedings to call for an exercise of this court's power of supervision.

The question presented is a vital one of great importance to not only financial institutions throughout the country, but to all business establishments who now do or who may hereafter require financing of this type. This court has already taken notice of the extent of account receivable financing in this country. In *Corn Exchange National Bank & Trust Company v. Klaunder* 318 U. S. 434; 87 L. ed. 884, this court observed (p. 437) that account receivable financing is a business of large magnitude. In a foot note to its opinion in that case, reference was made to Saulnier and Jacoby, *Accounts Receivable Financing* (National Bureau of Economic Research, 1943) where an estimate was made that in 1941 commercial finance companies advanced \$536,000,000.00 on this type of financing and commercial banks, an additional \$952,000,000.00. Financial institutions will not be able to continue account receivable financing if courts can draw presumptions such as those indulged in by the court below. If it is to be presumed that a secured indebtedness owing four months prior to bankruptcy was paid in all cases out of subsequently assigned accounts, without record proof to establish such presumption, and

particularly in instances where the record proof is to the contrary, it is obvious that a commercially recognized and useful method of financing will have to be eliminated and business establishments throughout the country deprived of their opportunity to secure needed financing on this type of security. A security transaction which has always been recognized and fully enforced by all of the courts of this country, would be converted by the device of presumptions into a situation resulting in all cases in a recoverable preference to the extent of the amount of the indebtedness owing on the day four months prior to bankruptcy. Governmental agencies like the Reconstruction Finance Corporation, as well as all of the banks and other large financial institutions of the country, will necessarily have to eliminate or largely curtail this type of financing, the economic need for which is so eloquently established by the extent of financing of this type done throughout the country.

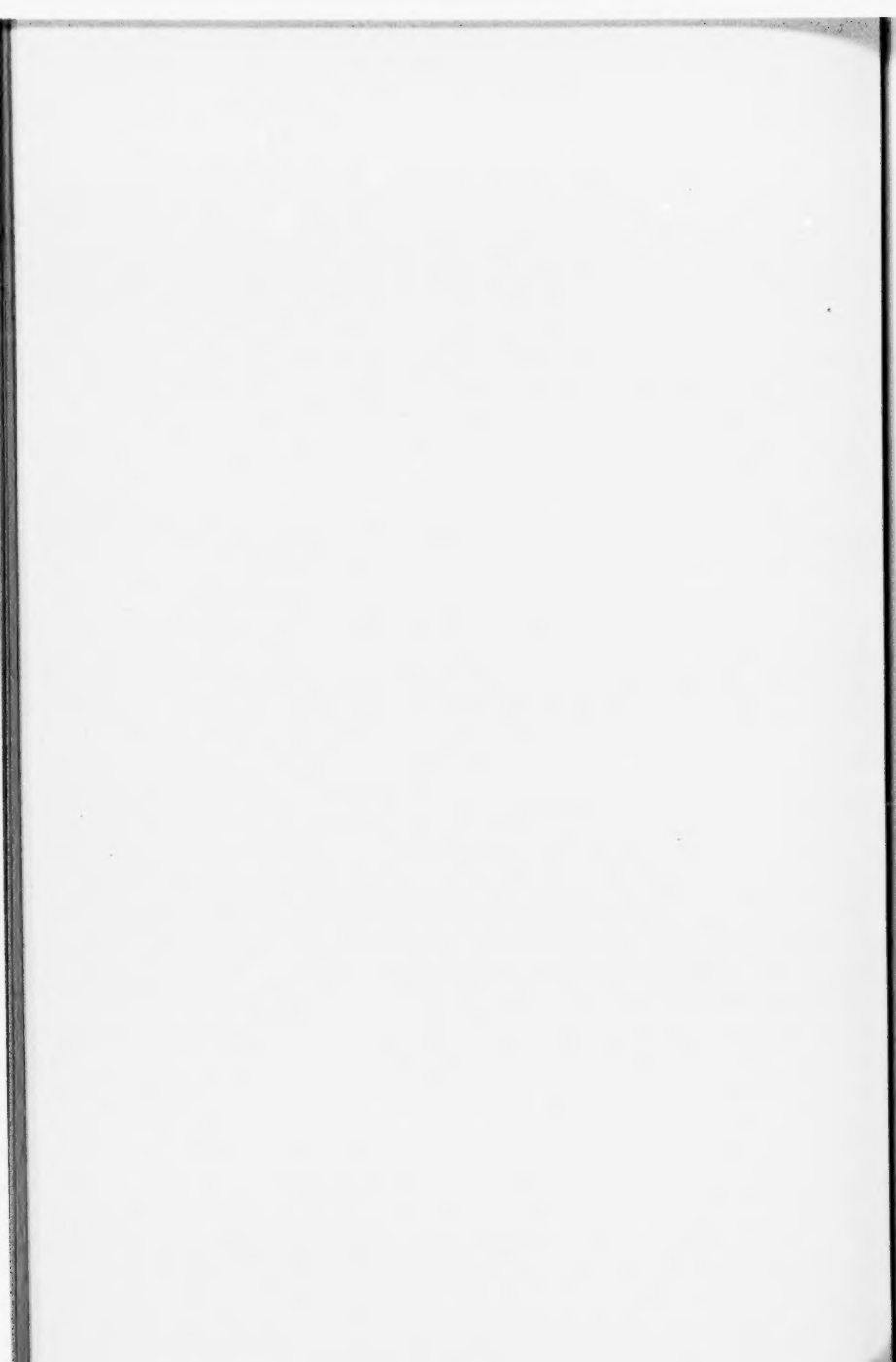
### CONCLUSION.

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We respectfully submit that the decision of the court below is a revolutionary departure from recognized authorities and one which finds no justification in the law. The problem presented by this decision is of immense importance and we therefore respectfully submit that it is a matter which should be reviewed by this Honorable Court.

Respectfully submitted,

EDWARD ROTHBART,  
J. M. ROSENFELD,  
*Attorneys for Petitioner.*



(20)

JUL 18 1944

CLERK OF THE SUPREME COURT  
U.S. DEPT. OF JUSTICE

IN THE  
**Supreme Court of the United States**

October Term, 1944

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No. 203

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**MANUFACTURERS' FINANCE COMPANY,**  
Petitioner  
V.

**DAVE MARKS, Trustee in Bankruptcy of**  
**BELMONT CANDY COMPANY, Bankrupt,**  
Respondent.

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**BRIEF OF RESPONDENT IN OPPOSITION TO  
PETITION FOR CERTIORARI.**

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**SAM P. WALKER,**  
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Memphis, Tennessee



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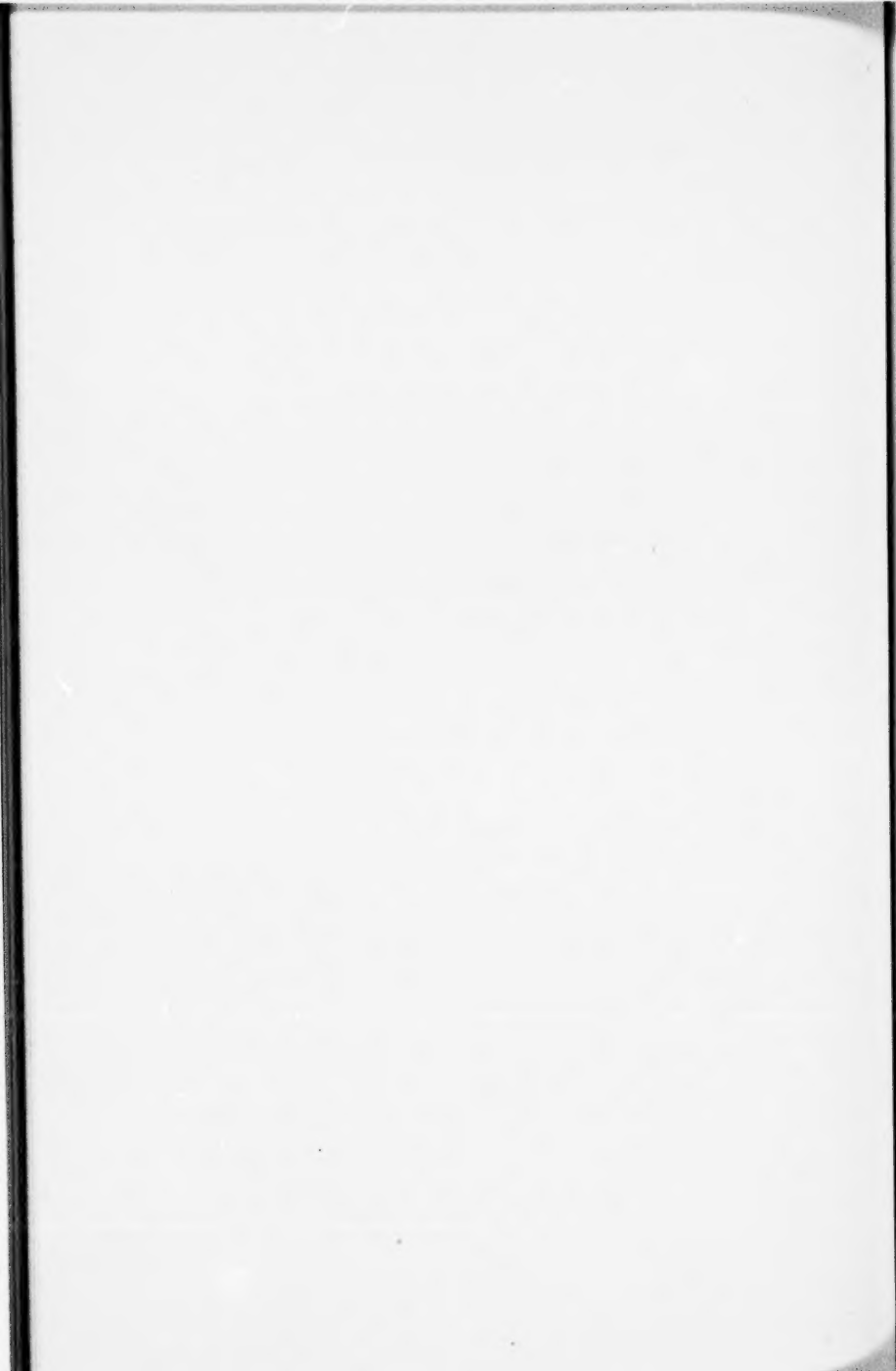
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## BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI.

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*To the Honorable, the Chief Justice and Associate  
Justices of the Supreme Court of the  
United States:*

The Statement of the Case and the questions presented in the petition for certiorari entirely fail to show the real facts and the real questions involved. In order to rectify this situation it is necessary to state certain vital and important facts entirely omitted in the petition.

Sometime prior to July 1, 1932, the petitioner, the Manufacturers' Finance Company, had been purchas-

ing assigned accounts of the bankrupt (Respondent), and no question is raised as to the legality of these transactions. About July 1, 1932, there was a diversion of funds by the bankrupt, and thereupon the petitioner placed E. L. Bradley, an auditor, in complete charge of the bankrupt's business in Memphis, and proceeded from that date to operate the business for its own exclusive benefit. After July 1 until October 6, 1932, Bradley had absolute control of the bankrupt's business (R. 229, 231, 281, 282, 284). Bradley controlled the credits, the accounts, the collections and all remittances to petitioner in Chicago.

Every single account created by the bankrupt was controlled by Bradley and sent to Chicago and every single collection on these accounts was personally handled by Bradley and remitted in kind to petitioner. (R. 107, 177, 187, 188.)

On October 6, 1932, the petitioner discontinued doing business with the bankrupt and thereafter all collections were made directly by it and the bankrupt had absolutely no knowledge of the accounts collected, the amounts paid or those that remained outstanding (R. 188). The business of the bankrupt from July 1, 1932, to October 6, 1932, was operated absolutely and exclusively for the benefit of petitioner. Without discussing the numerous facts and circumstances surrounding this situation we summarize it by stating that the Referee in Bankruptcy (R. 230), and the District Court in nine different places (R. 265 to 292) held that all of these transactions were fraudulent.

The United States Circuit Court of Appeals for the Sixth Circuit in its opinion holds that the verbal agree-

ment of July 1, 1932, was made in contemplation of insolvency and constituted a fraudulent preference (R. 340). We have a case of the Referee, the District Court and the Court of Appeals all concurring in a find of fact that the petitioner was guilty of creating a fraudulent preference, in that it transferred to itself all of the liquid assets of the bankrupt, obviously resulting in hindering and delaying its other creditors (R. 340, 341).

In its petition for certiorari the petitioner states that the decree of the District Court was based on an "alleged preference." This is not a correct statement. The three courts mentioned have held that the decree is based on a proven fraudulent preference, hindering and delaying creditors. There is no surmise or presumption about this and we submit that this Court will not examine into the record to ascertain the correctness of these facts. The case, therefore, presented is one of a fraudulent preference, concurred in by three separate courts and we submit that this Court will accept these findings of fact as final.

The law on this subject is thoroughly settled.

*In re Willoughby, et al., Berry v. Austin, et al.,*  
95 Fed. (2d), 932 (6th Cir.).

*Fruehauf Trailer Co. v. Bridge,*  
84 Fed. (2d), 660.

*Atlanta Knitting Mills v. Nathanson Bros. Co.,*  
64 Fed. (2d), 912.

*Dickinson v. O. & W. Thum Co.,*  
8 Fed. (2d), 570.

*Roberts v. Southern Surety Company,*  
33 Fed. (2d), 501.

The sole issue, therefore, that is presented in the petition for certiorari is based on a fraudulent preference,

deliberately conceived and entered into by the petitioner, resulting in great benefit to itself and hindering and delaying other creditors.

We submit that the opinion of the Court of Appeals on this question is final and conclusive. The Court says:

“The burden was on the Trustee to establish every element of a preference (Cainwright v. General Finance Corp., 123 Fed (2d) 98 (C. C. A. 7); First National Bank of Negaunce v. Fox, 111 Fed. (2d) 810 (C. C. A. 6), and this burden he has sustained.”

The petition for certiorari absolutely ignores and omits this all important proposition of fact and law.

This is not a case of ordinary assignments of accounts where the collections were made by the assignor and in turn remitted to the assignee. On the contrary, the assignor had no control with either the creation of the accounts, their assignment or the collection of their proceeds. All of this was done by Bradley, the agent of the petitioner located in respondent's plant in Memphis. The issues presented, therefore, are not those set forth at page 5 of the petition.

### **QUESTION AT ISSUE**

Where a finance company obtains a fraudulent preference by taking possession of the business of a bankrupt, operates it for its own benefit through its own agent, and all collections are made through this agent directly to it, and it has the absolute and exclusive knowledge of all accounts paid, the burden of proof is on the finance company to disclose the actual facts as to payments of accounts, and its failure or refusal to

do so is and of itself fraud on the other creditors, and a presumption arises against the legitimacy of such payments.

The petition should be denied because it does not present any issue within the scope of the statute authorizing the granting of a petition for certiorari.

The reasons relied on in the petition are (1) that there is a conflict between this decision and other decisions of Circuit Courts of Appeals; (2) that an important question of Federal law has been decided contrary to the decisions of this Court and is against the established authority; and (3) that the Court departed from the usual course of jurisdictional proceedings so as to call for an exercise by this Court of its power of supervision.

We will answer each of these propositions in the same order.

## ARGUMENT

### No Conflict of Authorities

The decision in this case is not in conflict with the decisions in the cases of *Israel v. Woodruff*, 299 Fed. 454 (C. C. A. 2); *Brown v. Christman*, 126 Fed. (2d), 625; *Stennick v. Jones*, 282 Fed., 161, for the reason that the facts in the instant case are entirely different.

We admit, and the Court of Appeals, held that the Trustees must establish every element of a preference, and this he has done (R. 340, 341).

In the case of *Israel v. Woodruff* there was no question of the fraudulent preference involved, nor does that case show that the actual facts with reference to payment of the accounts, were exclusively in the possession of the creditor; on the contrary, these facts were all in the exclusive possession of the bankrupt.

The case of *Brown v. Christman*, et al, if it is an authority for anything, sustains the Trustee's contention, because in that case the administratrix of an estate set up the defense that where money was deposited from rents collected by the deceased that the burden was on the owners of the property to show that the money in the hands of the administratrix was a part of the rent collected. Manifestly this was not sound, because the administratrix had in her possession all of the information with reference to these accounts and it was up to her to account for the rents collected. When it is shown that information is exclusively in the hands of one party to litigation, the law is well settled that the burden of proof is upon this party to disclose all of the facts.

The case of Stennick v. Jones can be easily distinguished because the defendant in that case took possession of certain property under a perfectly legal and valid contract in a perfectly legal and valid manner. There was no question of fraud or a fraudulent preference involved and, therefore, the case is not in point.

A complete answer to these cases is the finding of fact by the District Court and the Court of Appeals that the petitioner obtained a fraudulent preference and had in its hands the necessary proof to show what was the actual result of such a fraud.

In its final analysis, the position of the petitioner is that having created a fraudulent preference by its own acts, with full knowledge of the insolvency of the bankrupt, and having in its possession full information with reference to moneys collected on assigned accounts, it is still not responsible for the results of the fraudulent preference, because the Trustee in Bankruptcy has not shown specifically the source of the collections. We assert that the petitioner having perpetrated a fraud on creditors is now seeking to escape the penalty by the suppression or failure to produce the proof, which it had in its possession.

Fraud works in the dark, and when the results of fraud are in the hands of the fraudulent creditor it does not lie in that creditor's mouth to call on any one for proof.

One of the best analogies to this situation is where an agent collects money belonging to his principal. The burden is on the principal to establish agency and the

right of the agent to make the collections. It is then the duty of the agent to render an accounting for the money collected.

*Corpus Juris Secundum*, Vol.. 3, Section 164 (b),  
p. 52, on Agency.

*Otero v. Banco de Sonora*,  
26 Ariz., 356; 225 Pac., 1112.

*National Bk. v. Ins. Co.*,  
104 U. S., 54.

*Meacham on Agency*, 2nd Edition, Sec. 1344.

There are numerous cases and situations where the burden of evidence shifts, and there are likewise numerous situations where certain facts having been established by the plaintiff, the burden is then on the defendant to exonerate itself.

*Equipment Acceptance Corp. v. Arnold Can Manufacturing Co.*,  
117 Fed (2d), 442 (6th Cir.).

In this case the Court held that where a negotiable instrument is acquired through a defective title the burden is then on the holder to show that it is a holder in due course for a valuable consideration.

Likewise the law imposes this burden of exoneration on the bailee for hire, where goods are delivered to it and the bailee fails to account for them on demand.

In the case of

*Commercial Molasses Corp. v. New York Tank & Barge Corp.*,  
314 U. S., 104; 86 Law Ed. 89,

the Court discussed the question of the burden of proof in case of a loss by a chartered carrier and held that

the burden of proof did not shift technically, but that the burden of explaining the loss was on the carrier. When it did so then it had met its obligation under the law. Of course, the facts are different, but the broad principle of law is stated by the Court as follows:

“The burden of proof in a litigation, wherever the law has placed it, does not shift with the evidence, and in determining whether petitioner has sustained the burden the question often is, as in this case, what inferences of fact he may summon to his aid. In answering it in this, as in others where breach of duty is the issue, the law takes into account the relative opportunity of the parties to know the fact in issue and to account for the loss which it is alleged is due to the breach. Since the bailee in general is in a better position than the bailor to know the cause of the loss and to show that it was one not involving the bailee’s liability, the law lays on him the duty to come forward with the information available to him.”

The rule of law applicable, therefore, in this case is the one laid down by the Court of Appeals and is supported by the above cited authorities.

In addition to the foregoing it is well established law that the failure to produce evidence in the possession and control of a party to any litigation raises the presumption that the evidence, if produced, would not be favorable.

*Kirby v. Talmage*,  
160 U. S., 379-383.

*20th American Jurisprudence (Evidence)*,  
Section 183, p. 188.

*Wetmore v. Rymer*,  
169 U. S., 115; 42 Law Ed., 682.

*Standard Oil Co. v. State*,  
117 Tenn., 618-672.  
*Moore on Fraudulent Conveyances*,  
Sec. 15, p. 913.  
*22 Corpus Juris*, 111.

This principle of law ties in with and is a part of the broad and fundamental proposition that every party to litigation, especially where that party is guilty of improper conduct, must disclose all the evidence in its possession. Assuming that the Trustee relied on a presumption that the accounts created prior to July 1, 1932, were paid from accounts created after that date, a complete answer to this presumption was in the possession of the petitioner. Instead of going forward with the evidence the petition undertakes to rely on a proposition of law. Having conducted itself so as to hinder, delay and defraud creditors, it now asks this Court to help it out by sanctioning its suppression of evidence. It wishes to take advantage of its improper conduct by refusing to disclose the evidence which was in its possession. This it cannot do and the Court of Appeals held that in view of the conduct of the petitioner that the burden was on it to establish the legitimacy of its reimbursements to itself subsequent to June 30, 1932 (R. 347).

The petitioner absolutely, without the knowledge of the officers of the bankrupt, created a so-called reserve account, designated by the District Court as "arbitrarily and fraudulently set up," which designation is affirmed by the Court of Appeals (R. 345). What accounts are in this reserve no one knows except the petitioner and it does not say. Having created a fraudulent reserve,

without the knowledge of the bankrupt's officials, it was certainly up to it to explain it and the Court of Appeals so held (R. 173, 178). See also

*Cliett v. Scott*,  
102 Fed. (2) 725.

Having created this situation by and through its own agent, and having in its possession all the facts, the burden was on the petitioner to disclose these facts and bring forward the information it had so as to rebut the presumption raised by the undisputed evidence.

The principles of law cited by the petitioner are sound on the facts of those cases, but they are not sound on the facts of this case. The Court of Appeals recognized this proposition and cites in support of its opinion the case of *Rossman v. Blunt*, 104 Fed. (2d) 877-880, where the rule is laid down as follows:

“The records of banks are ordinarily kept by its confidential agents and employees, the customers and the public generally not having access to them and on receivership, the receiver becomes their sole custodian.

“The proof on behalf of appellee shows prima facie that the receiver's assets were augmented by the proceeds of the draft. *Mammoth Oil Company v. United States*, 275 U. S., 13, 14, 52, 48 S. Ct. 1, 72 L. Ed. 137. In such case, all of the evidence admissible upon the question being in the possession of the receiver and not easily attainable by the appellee the burden shifts to him to show that his assets were not augmented by the proceeds of the draft. *Selma, Rome & Dalton Railroad Company v. United States*, 139 U. S., 560, 568, 11 S. Ct., 638, 35 L. Ed. 266. The burden of proof rested on the appellee to show that his property had been wrong-

fully mingled with the mass property of the bank, but under the peculiar facts of this case when that was done, the burden of going forward with the evidence shifted to the receiver. *Smith v. Mottley*, 6 Cir., 150 F 266."

In addition to the foregoing the case of

*Brown v. Mars, Inc.*,

135 Fed. (2d), 843, 850 (8th Circuit)

in discussing the question of the burden of proof where a suit was filed to enjoin violation of the Emergency Price Control Act of 1942, the Court held that the burden of proof rested on the defendant, Mars, Inc., to show that the maximum prices charged were caused by manufacturing formulae or methods and gives two reasons, the first of which is not applicable. The second reason given is directly in point and furthermore cites all of the Federal cases up to date on this question of burden of proof. The Court says:

"The second reason is that the evidence to prove the existence of and the effect upon product weights of manufacturing methods and of changes in formulae is peculiarly within the knowledge of the manufacturer, *United States v. Denver & R. G. R. Co.* 191 U. S. 84, 92, 24 S. Ct. 33, L. Ed. 106; *Selma, etc., R. C. v. United States* 139 U.S. 560, 567, 568, 11 S. Ct. 638, 35 L. Ed. 266; *Rossman v. Blunt*, 6 Cir., 104 F. 2d 877, 880; *Cliett v. Scott*, 5 Cir., 102 F. 2d 725; *Miller v. Lykes Bros., etc., Co.*, 5 Cir., 98 F. 2d 185, 186, certiorari denied 305 U. S. 641, 59 S. Ct. 150, 83 L. Ed. 413, *Liberty Bell Gold Mining Co. v. Smugler-Union Mining Co.*, 8 Cir., 203 F. 795, 804, certiorari denied 231 U. S. 747, 34 S. Ct. 320, 58 L. Ed. 464; *The Medea*, 9 Cir., 179 F. 781, 786; *West v. W. A. McLaughlin & Co.'s Trustee*, 6 Cir., 162 F. 124, 128."

It, therefore, results that the so-called conflict with other decisions of courts of appeals does not exist.

## II

### No Presumption on a Presumption

The next proposition advanced by the petitioner is that the basis of the decision rested on a presumption admittedly unsupported by the record and upon another presumption built on the first resumption. Neither of these propositions is correct nor are they supported by the record. In spite of the ruling of three courts to the contrary, the petitioner makes this extraordinary statement in his argument. See petition pp. 17, 18.

“It is *admitted* (italics ours) on the record that all of the collections on all accounts during the period from June 30, 1932, to October 6, 1932, were made by the bankrupt and forwarded to petitioner. That was the date after which petitioner purchased no further accounts from bankrupt and several days thereafter petitioner gave notice to the debtors to pay the accounts directly to it.”

The collections were not made by the bankrupt but were made by Bradley, the agent of the petitioner, who was in Memphis, and controlled these collections (R. 107, 177, 187, 188). He attended to the assigning of the accounts and he alone had the key to the mail box through which collections were made and he alone forwarded these collections to the petitioner in Chicago. In short, the bankrupt did not make these collections, except in name. The real facts, without dispute, show that the collections were made by the petitioner itself, through Bradley, sent in kind to Chicago and yet the whole argu-

ment of the petitioner is based on the statement that all collections were made by the bankrupt.

We agree that ordinarily a legal presumption arises that all payments made by a bankrupt are valid and the burden is on the Trustee to show to the contrary, but where the Trustee proves a fraudulent scheme to hinder and delay creditors, and further shows that collections or payments were not made by the bankrupt, but made through the agent of the creditor, then this presumption manifestly does not apply.

The case of

*Israel v. Woodruff,*

299 Fed. 454 (C. C. A. 2)

quoted by the petitioner sustains our proposition exactly, inasmuch as it says:

“The payments by the bankrupt were consistent with honesty in every part, and the burden was on the appellant to show that payments were not made from the proceeds of the sale of the potatoes.”

The payments in this case are not consistent with honesty, because they were not made by the bankrupt, but made by petitioner to itself through Bradley.

If the petitioner made any collections of these accounts it knows it and it mingled the proceeds with all other accounts and, therefore, it could and should produce the evidence as to which accounts were paid. This is particularly true because after October 6th, 1932, the collections were never even sent to the bankrupt, but were made direct by petitioner. There is no presumption based on a presumption at all. The case shows a

fraudulent scheme on the part of the petitioner to hinder and delay creditors, which was duly carried out by its agent Bradley. Having created a condition through this fraudulent scheme, including the so-called reserve, and having so conducted the bankrupt's affairs that all other creditors were hindered, delayed and defrauded, petitioner is not in a position to claim that there is any presumption of fair dealing on its part.

The Trustee has established the fundamental facts and is merely asking that the petitioner make good a part of the loss to these creditors. More than \$20,000 of new debts were created after July 1, 1932, which are entirely unpaid (R. 242, 245).

There are numerous cases to the effect that every single assignment made by the petitioner after July 1, 1942, is void and the Trustee would be entitled to recover the value of these accounts, regardless of the consideration paid by the petitioner. See the following cases:

*In re Farm & Home Co.*

84 Fed (2) 933.

*Collier on Bankruptcy,*

14th Ed., Vol. 4, p. 344.

*Corpus Juris Secundum (Bankruptcy),*

Sec. 240, p. 861.

*Lowenstein v. Reikes,*

60 Fed. (2d), 933.

*Buffum v. Peter Barcelona Co.,*

289 U. S. 227; 77 Law Ed. 1140.

The only other proposition presented by the petition is that this decision by the Court of Appeals would seriously affect the operations of financing companies which purchase accounts under the authority of the

Manufacturers' Finance Company v. McKey, 294 U. S. 442, 79 L. Ed., 982.

A careful reading of the opinion shows that this case does not in the slightest affect fair and legitimate financing. It simply holds that where a finance company has been guilty of entering into a fraudulent scheme resulting in delaying and hindering creditors that the burden is on such a creditor to show that payments made to it were legitimate. The decision is based on the peculiar facts of this case and have no bearing on the general principles of financing, other than it is a fair warning to such companies to treat their debtors and other creditors fairly and honestly. It simply holds that such companies convicted of obtaining a fraudulent preference must disclose the facts and information within their exclusive possession. Any finance company that acts and conducts itself according to the principles laid down in Manufacturers' Finance Company against McKey would have no trouble.

We, therefore, submit that the granting of this petition should be denied on the ground that this decision is not contrary to the decisions of other Circuit Courts of Appeal. This case is exactly in accordance with the cases of other Courts of Appeal and of this Court. The decision is not contrary to any decision in this Court, nor is it of vital or great importance to financial institutions that conduct their business on a proper basis.

In addition to that it is manifest that the merits of this case have been reached and there is no necessity or need to prolong this litigation.

We, therefore, submit that this petition should be denied.

Respectfully submitted,

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(31)  
IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

**No. 203**

MANUFACTURERS' FINANCE COMPANY,  
*Petitioner,*

vs.

DAVE MARKS, TRUSTEE IN BANKRUPTCY OF  
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*Respondent.*

**REPLY BRIEF IN SUPPORT OF PETITION  
FOR WRIT OF CERTIORARI.**

EDWARD ROTHBART,  
J. M. ROSENFELD,  
of Chicago, Illinois,  
*Attorneys for Petitioner.*



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**REPLY BRIEF IN SUPPORT OF PETITION  
FOR WRIT OF CERTIORARI.**

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*To the Honorable, the Chief Justice and Associate  
Justices of the Supreme Court of the United States:*

The brief of respondent is based primarily upon two assertions—first, that the courts below have found that a fraudulent preference existed, and second, that since petitioner had the “absolute and exclusive knowledge of all accounts paid” the burden was upon petitioner to establish all facts, and “that its failure to do so is of itself fraud on the other creditors, resulting in a presumption against the legitimacy of the payments” made to petitioner by bankrupt. We shall take these points up in order.

## I.

This is not a case where a fraudulent preference or conveyance has been established by evidence produced in the record; on the contrary, the alleged fraudulent preference is grounded upon a presumption *wholly unsupported by the record*. We are here dealing with the *determination of whether a preference exists*, not with the legal situation which arises in connection with introducing evidence after a preference has been properly established.

The courts below based the preference allegedly secured by petitioner on the *presumption* that the indebtedness of \$12,214.20 owing petitioner on July 1, 1932 (to secure which petitioner had assigned accounts in the aggregate amount of \$18,632.82) (R. 271) was paid to petitioner exclusively out of the proceeds of accounts assigned thereafter. This is the vital crux of the opinions of the courts below and the only basis upon which any preference could exist. The Circuit Court of Appeals specifically grounded their opinion on that point, stating "The controlling question as to the item of \$12,214.20, for which the District Court gave judgment against the appellant, is the source of the collections made between June 30, 1932, and October 6, 1932, from which appellant reimbursed itself for this sum." (R. 349). The *only* claimed preference is that petitioner reimbursed itself for the sum of \$12,214.20 owing it July 1, 1932 out of subsequently assigned accounts. (R. 341.)

The courts below recognized and specifically stated that the repayment of the sum of \$12,214.20 to petitioner is justified only to the extent that such repayment was made out of accounts already on hand July 1, 1932 (R. 347). If, according to the opinion of the Cir-

cuit Court of Appeals, such sum was *not* repaid out of subsequently assigned accounts, *there obviously could be no recoverable preference*. If, on the other hand, such sum was paid out of subsequently assigned accounts then, according to the Circuit Court of Appeals' opinion, there was a recoverable preference. The existence or non-existence of the recoverable preference, therefore depends exclusively upon the question of whether such indebtedness was or was not paid out of subsequently assigned accounts. The Circuit Court of Appeals has held in such a situation that there is no burden upon the trustee to establish the facts which necessarily must be established before the preference can come into existence.

Respondent has attempted to create the impression that the alleged preference has already been established and that therefore, because of such preference, the burden of proof was upon petitioner rather than upon the trustee in bankruptcy to establish the facts in connection with which the preference was secured. He overlooks completely that these facts, wholly missing from the record, are necessarily and vital as a condition precedent to the establishment of the preference. The preference depends upon factual proof—that the indebtedness owing petitioner on July 1st was paid out of subsequently assigned accounts. Without such proof there can be no preference. There is no proof to such effect in the record and, as we have pointed out, the record is expressly to the contrary.

Under such circumstances it cannot be questioned under all of the decisions of this court and all other decisions on the subject that the burden was with the respondent throughout to establish the preference which he alleged.

Furthermore, it is obvious and indisputable on this record that it is impossible that the major portion or any substantial portion of the indebtedness of \$12,214.20 owing petitioner July 1, 1932 was paid out of subsequently assigned accounts. This conclusion appears from the testimony of petitioner as well as that of respondent, *and is without contradiction.*

Primarily, the record conclusively shows that on July 1, 1932 petitioner had on hand valid, unassailable assignments of accounts in the aggregate sum of \$18,632.85. Counting all of the accounts, both those on hand July 1, 1932 and all of those subsequently assigned to petitioner, the record shows that there now remain uncollected accounts in the total aggregate sum of \$7,900.51 (R. 344). All other accounts have been collected. Even assuming that all of the uncollected accounts are accounts assigned prior to July 1, 1932 (which is not a very likely possibility but which is the very most that respondent could contend) *at least the difference or \$10,732.34 was collected on accounts already on hand July 1, 1932.* This difference of \$10,732.34, as we have above indicated, and which is obvious from the record, is the very *least* that could have been collected on accounts already on hand July 1, 1932 and applied toward the reduction of the indebtedness owing of \$12,214.20.

To approach the problem another way, but which leads to the same conclusion, it is admitted on the record that after July 1, 1932 the total number of accounts assigned to petitioner aggregated \$71,067.47 (R. 345). It is further admitted on the record that after July 1, 1932 bankrupt collected and forwarded to petitioner in cash on assigned accounts receivable the sum of \$78,573.09 (R. 150). It is also admitted that the receiver

thereafter collected on such assigned accounts the sum of \$431.30, that the trustee collected thereon the additional sum of \$647.07, and that petitioner further collected thereon the additional sum of \$1,941.32. Thus, the total amount of cash collected after July 1, 1932 on *all assigned accounts* is in the aggregate sum of \$81,-592.78 (the total of the four items last mentioned), or \$10,525.31 *over and above 100 per cent of the face amount of all accounts assigned subsequent to July 1, 1932*. We cannot emphasize too much that these facts are uncontradicted of record. Thus, it is obvious again that *at least* \$10,525.31 was collected on accounts assigned prior to July 1, 1932 and that *at least* that much of the indebtedness of \$12,214.20 owing petitioner July 1, 1932 was paid exclusively out of accounts already on hand July 1, 1932.

If, therefore, as the courts below have found, the determination of the question as to whether a preference exists depends upon the question of whether the indebtedness of \$12,214.20 was paid to petitioner out of subsequently assigned accounts, it is obvious that the courts below have done exactly what we argued they did in our main brief—they have built a preference upon a presumption, wholly unsupported by, and contrary to the record, that a substantial part of such indebtedness owing to petitioner July 1, 1932 was paid out of subsequently assigned accounts; and upon a second presumption, built upon the first, that such entire indebtedness was paid *exclusively* out of accounts assigned subsequent to July 1, 1932. It is one thing to hold that where a fraudulent preference has been established, and where all of the evidence as to the money or property received by the fraudulent transferee is in his sole possession, the burden of proof then shifts to such transferee to establish the facts. It is quite another to hold

that the fundamental crux or foundation necessary to *establish* the preference itself must be shown *not to have existed* by the transferee against whom the cause of action is brought.

## II.

Much confusion has been built up in the presentation of respondent's theory by reference to authorities which have no application to the facts of the case at bar and by numerous unwarranted and wholly unsupported statements calculated to convey an entirely improper impression of the facts of the case. This is particularly true with respect to the statements made as to the alleged control of Bradley over the business of the bankrupt after July 1, 1932. Without intending to go into factual matters at this time, a fair reading of the record shows that after a diversion of funds by bankrupt, petitioner insisted, as a condition to purchasing further accounts from bankrupt, that it station one of its traveling auditors in bankrupt's place of business to see that all collections on assigned accounts were turned over to petitioner. Bankrupt's president, testifying as a witness for the trustee in bankruptcy (this witness was and still is ~~the receiver~~ in bankruptcy for the bankrupt) stated (R. 107) that additional conditions were made—that he was to have the sole key to the mail box, have a right to countersign checks, limiting the purchases of raw materials, etc. This has been magnified by respondent in his brief to such statements as those appearing on page 2 of his brief, that the business of bankrupt after July 1, "was operated absolutely and exclusively for the benefit of petitioner." Similar statements appear throughout the brief.

Nothing is alleged or argued other than the fact that all of the bankrupt's accounts receivable were sold to petitioner and that it received the proceeds of the collections on all of those accounts receivable. No other damage is claimed to have resulted or been caused to bankrupt or its creditors. The contract specifically provided (R. 10c) that bankrupt would not sell or assign any of its accounts elsewhere without giving ten days' written notice to petitioner of such intention. Thus, the agreement was in the nature of an exclusive agreement whereunder bankrupt agreed to sell all of its accounts to petitioner, which is not unusual in matters of this kind. Nor could any damage or loss occur to either the bankrupt or any of its creditors. The purchase price of the accounts purchased by petitioner was 100 per cent of their face value of which 70 per cent was paid in cash at the time of the purchase and the remainder at the time of the collection of the accounts, less petitioner's charge for its services. A striking fact appearing from the record is the amount of cash actually received by bankrupt from petitioner in connection with its transactions under the contract. As we have pointed out above, on July 1, 1932 petitioner had on hand accounts theretofore purchased from bankrupt in the aggregate sum of \$18,632.85. Thereafter, the total aggregate amount of all accounts assigned to petitioner was in the sum of \$71,067.47 or a total of \$89,700.32 in accounts in all. There remain uncollected accounts in the aggregate sum of \$7,900.51 so that there is a net of \$81,799.81 of all accounts involved in this lawsuit.

The record shows that bankrupt and its trustee have already received over \$79,000.00 in cash with respect to those accounts. This is arrived at by taking the amount of money which the record shows, without con-

tradiction, was paid to bankrupt in connection with those accounts as follows:

(a) There was paid to bankrupt on accounts aggregating \$18,632.85 prior to July 1, 1932, the sum of (R. 317)	\$13,125.88
(b) There was subsequently paid to bankrupt in cash the sum of (R. 353-362)	64,947.47
(c) In addition, the receiver collected in cash the sum of (R. 287)	431.30
(d) The trustee the additional sum of (R. 287)	647.07
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making the total cash received by bankrupt on these accounts and by its receiver and trustee in bankruptcy in the sum of ..... \$79,151.72

The District Court found, and the Circuit Court of Appeals approved, the allowance to petitioner of compensation according to the contract rate up to but not after the date of bankruptcy in the sum of \$823.15 (R. 296). No reason appears for not paying petitioner compensation due in accordance with the contract after the date of bankruptcy. Such payment has heretofore been authorized. (*Manufacturers Finance Co. v. McKey*, 294 U.S. 442, 79 L. ed. 982.) However, if we only include the amount of compensation admittedly allowable up to the date of bankruptcy and add that to the amount of cash received respecting these accounts, the total amounts to the sum of \$79,974.87. This is in respect of accounts in the total sum of \$81,799.81 or a difference of only \$1,824.94. This small difference is more than accounted for when it is considered that actually the books of petitioner were kept on the basis of accounts cleared and not on the basis of actual cash received. Thus,

if there were some small discrepancies in the accounts, or some deductions by debtors for freight allowances, discounts or other similar matters, they would have to be deducted from the small amount of difference referred to.

In addition, petitioner collected \$1941.32 on these accounts pursuant to an order of the bankruptcy court. Judgment was rendered against petitioner to repay this sum to respondent (in addition to the \$12,214.20 found to have been received by petitioner as a preference). If the judgment below stands as to the collections of \$1941.32, respondent will be receiving \$116.38 *more than 100 per cent* of the face amount of all accounts receivable involved. *In addition*, it will receive \$12,214.20 as an alleged preference plus some smaller items and over \$10,000.00 by way of interest.

If bankrupt had never entered into the contract with petitioner, it would have retained its accounts receivable and collected them in due course, the same as it did while the contract with petitioner was in existence. No one contends that it could have collected more on those accounts than what was actually collected on them. The only difference is that it would not have received any immediate payments but would have had to wait until the customers paid the accounts. Certainly no creditor was harmed by bankrupt receiving 70 per cent immediately and waiting until the individual accounts paid out to receive the remaining 30 per cent. And certainly no reason exists for bankrupt and its trustee now receiving more than \$12,000.00 *over and above* 100 per cent of the full face amount of every account receivable assigned to petitioner.

It is obvious, therefore, notwithstanding respondent's efforts to the contrary, that the transactions presented

on this record are certainly not any different than normal transactions on accounts receivable financing between a finance company and a mercantile institution. Bankrupt received all the advantages of receiving the great percentage of its accounts receivable immediately upon shipment of the merchandise. Its total cost for all of this service during the four months prior to bankruptcy is the sum of \$823.15, allowed petitioner by way of compensation, plus the small discount of  $1/5$  of 1 per cent of the face amount of all accounts purchased. ( $1/5$  of 1 per cent of the \$71,067.47 in accounts purchased after July 1, 1932 amounts to only \$142.13.)

All of the foregoing facts, in our opinion, more than justify the argument contained in our main brief that the conclusion arrived at by the courts below is a serious departure from all of the known authorities, and, if not modified, will constitute a serious threat to the continuance of a type of financing which has always received the sanction of the courts. (*Manufacturers Finance Company v. McKey*, 294 U.S. 442, 79 L. ed. 982.)

### III.

Respondent's brief assumes throughout that no evidence of any kind was introduced by petitioner. In so doing he completely ignores the record. While we have contended and still do contend that the burden was with the respondent in the first instance, and remained with him throughout, to establish every element of the claimed preference, petitioner does not now rest exclusively on that affirmative rule of law. On the contrary, it introduced evidence including the testimony of two witnesses E. L. Bradley (R. 159) and R. T. Hamilton (R. 182). Furthermore, and more important, it intro-

duced its ledger sheets on all transactions with the bankrupt during the period in question. Those ledger sheets were properly identified, proper foundations laid in accordance with law, and they were introduced in evidence *without objection* (R. 197, 198, 202). They were sent up in the original form to this Honorable Court and are a part of the record in this case. Those exhibits show all necessary facts to establish all of petitioner's contentions as set forth herein. They show the amount of accounts purchased, the amount of collections received on the accounts and the amount of cash paid to bankrupt in connection therewith. The entries are made daily in connection with every transaction had between the parties during the period here involved, without exception, and record the full history and picture of those transactions. The only thing which those ledger sheets do not record and which it is impossible for those ledger sheets to have recorded, is a breakdown showing the source of each individual collection. In other words, there is no breakdown on those ledger sheets showing whether or not the collections made were made on accounts assigned prior or subsequent to July 1, 1932. Two obvious reasons give a complete answer as to why such information is not shown on those ledger sheets. First, there was no reason to make any distinction between the transactions had prior to July 1, 1932 and those had subsequently. Secondly, and more important, practically all of those collections *were not made by petitioner*. On the contrary, they were made by bankrupt. Mr. Floyd, who was president of bankrupt before bankruptcy and who thereafter was appointed and remains to this day its receiver in bankruptcy, testified (R. 156) to the exact amount of moneys collected by *bankrupt* month by month during the months of July to and including No-

vember, 1932. He was then asked by his own counsel (R. 150) :

"Q. 367 Is that report the actual money collected by the company during that time?

A. That is money collected by us and sent to them."

There is no other or contrary evidence in the record.

Obviously, therefore, respondent, and not petitioner, had or should have had in its possession, and was the *only one* who had the books and records showing the identity of the particular accounts as to which the collections were made. The contract provided (R. 10b) that in order to avoid objections by, and any possible loss of trade from customers through petitioner collecting the accounts directly from the debtors, bankrupt was given the right to make collections at its office of all accounts sold to petitioner, agreeing on the day of the receipt thereof, to transfer and deliver to petitioner all original checks, drafts, notes and other evidences of payment received in payment or on account of any accounts purchased thereunder. It is undisputed that bankrupt had such books, that they were left with the bankrupt at the time of bankruptcy (R. 168) and were in possession of the receiver who failed to produce them, although demand was made upon him to do so by counsel for petitioner (R. 144). Petitioner obviously produced all pertinent information and all admissible evidence in its possession on that subject when it introduced all of its ledger sheets. Those ledger sheets do not corroborate the *unsupported theory* of respondent. Nowhere is there any evidence to support such theory. Nevertheless, the preference alleged to have been received depends *exclusively* upon the *theory* that the indebtedness owing petitioner on July 1, 1932 was paid in its *entirety* out of

subsequently assigned accounts. It is respectfully submitted that such theory is not only unsupported by the record, but that it is expressly contrary to the record. Under such circumstances the claimed preference vanishes completely.

### CONCLUSION.

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We respectfully submit that the matter here presented to your Honors is a matter of most vital importance to financial institutions of all kind throughout the country and as well to literally thousands of business establishments who depend upon this type of financing. It is a perfectly proper, legitimate and well recognized method of financing and one that has always been recognized as sound economically and legally enforceable. The holdings of the courts below will seriously jeopardize if not destroy this type of financing. The decisions of the court below are contrary to all other reported decisions on the subject. They are expressly contrary to the decisions of the Circuit Courts of Appeals for the 2nd and 9th circuits and for the District of Columbia. The effect of the decisions below is to raise a presumption, regardless of the facts and the state of the record, that the amount owing under this type of financing on the date four months prior to bankruptcy was paid out of accounts purchased within the four month period. There is no basis in fact or in law for such a decision or presumption, and we submit that it is of the highest importance that this Honorable Court grant an opportunity to have the matter presented upon full briefs and oral argument so that the decision can be reviewed by this court and the law on the subject settled.

We respectfully pray that, all circumstances considered, this Honorable Court grant the petition and issue its writ of certiorari to review the judgment appealed from.

Respectfully submitted,

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